No. 12961

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

HERSCHEL BULLEN, MARY H. BULLEN, J. C. HAYWARD and MARY S. HAYWARD,

Appellants,

vs.

ADAMANT COMPANY, WALTER B. SCOVILLE, JOE SEEPLE and HARRY WYNN; UNITED STATES OF AMERICA and RECONSTRUCTION FINANCE CORPORATION,

Appellees.

Reply Brief of Appellants Herschel Bullen, Mary H. Bullen, J. C. Hayward and Mary S. Hayward to Appellees' Brief of the Adamant Company, Walter B. Scoville, Joe Seeple and Harry Wynn.

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Herschel Bullen, Mary H. Bullen, J. C. Hayward and Mary S. Hayward, as appellants in this case, submit herewith their closing brief replying to the "reply brief" of Adamant Company, Walter B. Scoville, Joe Seeple and Harry Wynn, appellees.

The appellees begin their argument by asserting, page 4 of their brief, that the two for one agreement is not a royalty. The question of whether the document creates a royalty is just a matter of language, and does not affect the substance of the problem. We called the two for one agreement a royalty because, under the law of California, it is a property interest in oil or the proceeds

thereof, and also because it is an interest in real property. If, as the appellees appear to assume, a royalty is limited to something that represents a continuing ownership, then they are right that the two for one agreement is not a royalty. While the Bullens and Haywards did not make a loan, a part of what they got for their investment, the two for one agreement, is in the nature of a security interest, and terminates when the holders have received $10,000.00 from the gross proceeds of production. It is, however, definitely more than a lien. As stated by the court construing a similar document in *Recovery Oil Co. v. Van Acker,* 96 Cal. App. 2d 909 at 912, 216 P. 2d 483 at 485:

> "Her interest was vested as an estate, and not as a lien. Her position was similar to that of the holder of a trust deed."

In the *Van Acker* case, as in our case, when the $10,000.00 was paid the estate would cease, just as the estate created by an ordinary trust deed ceases when the note or other obligation which it is given to secure has been paid.

The statement on page 5 of the reply brief of The Adamant Company, Walter B. Scoville, *et al.,* as follows:

> "In the *Van Acker* case, *supra,* the interest created by the assignments constituted a direct proportion of the oil, gas and other hydrocarbon substances."

is in error, if by that statement it is intended to convey the thought that the holder of the assignment in the *Van Acker* case had a continuing interest after the $10,-

000.00 had been paid. As said by the court in 96 Cal. App. 2d at page 912, 216 P. 2d at page 485:

> "The assignments by which the respondent acquired her interest assigned to her a certain share in the production from the land *until such time as she received $10,000.00. Her interest was to terminate when she received this amount,* otherwise it would run for the full term of the lease." (Italics ours.)

The document, which has been called for convenience "the two for one agreement," is referred to several times by the appellees as "a bonus contract." We see no legal significance in either designation. The appellants invested $5,000.00 in a wildcat oil well, and it was agreed that they would receive $10,000.00 out of the first 15% of gross production. This is precisely what the document involved in the *Van Acker* case entitled the holder to receive. The facts that in our case it represents a two for one return on the investment, and that the appellants were also to receive a 2% participating royalty which was a continuing interest in the well, are, we submit, immaterial.

We repeat that the *Van Acker* case is absolutely on all fours with the case at bar in so far as the two for one agreement is concerned. The only distinction between that case and ours has been pointed out on pages 17 and 18 of our opening brief, and that is a distinction without a difference.

At page 8 of their brief, the appellees discuss *Austin v. Hallmark Oil Co.,* 21 Cal. 2d 718, 134 P. 2d 777. We cited this case, at page 18 of our brief, merely for the

proposition that no particular form is required to transfer an interest in an oil lease. That should apply to a security interest, a limited royalty, or whatever the two for one agreement is properly called, as well as one of continuing ownership, the latter being involved in the *Hallmark* case.

The case of *Helvering v. O'Donnell,* 303 U. S. 370, 82 L. Ed. 903, was a tax case involving the question of whether the holder of an agreement entitling him to one-third of the net profits from the operation of certain oil properties, was entitled to a depletion allowance. The Supreme Court held that he was not, reversing a decision by this Court. The Supreme Court said, at 82 L. Ed. 904:

> "The agreement to pay respondent one-third of the net profits derived from the development and operation of the properties was a personal covenant and did not purport to grant respondent an interest in the properties themselves."

This statement is simply wrong. The California law, though in a state of flux at the time, was and is otherwise. (*Schiffman v. Richfield Oil Co.,* 8 Cal. 2d 211, 64 P. 2d 1081.) If the quoted statement were good law, nothing would be payable out of the award in this case to the holders of the participating royalties, most of which are held by The Adamant Company, Scoville, *et al.,* and they should be the last to cite the case. In any event, it does not apply to the two for one agreement held by the Bullens and Haywards, which, as the appellees point

out, is not a participating royalty. It is not participating in the technical sense, because the interest is in *gross* production. It is not participating in a general sense, because it does not continue indefinitely, but ceases when a certain sum has been paid.

The case of *Morrison v. Havens,* 24 Cal. App. 2d 504, 75 P. 2d 515, cited on page 11 of appellees' brief, involved the interpretation of a document which the court characterized as an "informal memorandum." We have, in our case, a very definite and specific agreement, even though it is contained in a letter [Petitioners Bullen and Haywards' Exhibit 1]. In view of the very recent *Van Acker* case, dealing with our precise facts, it is submitted that we need not be concerned with older cases or general authorities.

At page 12 of the appellees' brief, they make the point that Treasure Company handled the proceeds of the well prior to its condemnation, which is, of course, true, and they argue from this that Treasure Company should be the only one liable for payment of the $10,000.00 out of 15% of gross production to which the Bullens and Haywards are entitled under the so-called two for one agreement. This misses the point as to the nature of the interest created by the two for one agreement. It is a specific agreement that a certain sum of money will be paid out of the production of the well, and it creates a charge in the nature of a trust deed upon all interests in the well owned by the people who were parties to it, or who were bound by it.

The two for one agreement does not depend upon the misapplication of trust funds, as does the lien held by the participating royalty holders, which arises from the failure to pay to them the net proceeds of production to which they were entitled. That lien, it is true, runs only against the interest of Treasure Company, which was the operator of the well, and which violated its fiduciary obligations to the other co-owners of the working interest, the participating royalty holders. The *Van Acker* case clearly establishes that the property interest created by the agreement to pay a specific sum of money out of the proceeds of production of an oil well does not depend upon the failure of the operator to pay over the money.

The statement of the appellees on page 13 that they fail to find any pledge of the interest of Walter B. Scoville as guaranteeing fulfillment of the two for one agreement ignores the fact that Scoville is the one who made the agreement. Whatever may be the situation as to The Adamant Company, Scoville's name was signed [R. 1196] to the letter agreement of September 27, 1938 [Petitioners Bullen and Haywards' Exhibit 1], which specifically provided:

> ". . . these funds, $5,000.00, to be included in the said necessary funds to be repaid two for one out of production . . ., it being understood and agreed to that the said two for one out of production is to be repaid out of the first 15% of gross production from the said well."

The appellees miss the point for which *Gates v. Salmon,* 35 Cal. 576, was cited. (This case is cited at page 28 of our brief, through a printer's error, as *Gapes v. Salmon.*) At page 13 of the appellees' brief, they quote the statement of the court, from page 587 of the opinion:

> "The rule upon this point is, that one tenant in common cannot convey any specific part of the land so as to prejudice his co-tenant."

This quotation might have been completed by language from page 588 of the opinion, as follows:

> "He cannot, of course, invest his grantee with rights greater than he possesses. The grantee must take, therefore, subject to the contingency of the loss of the premises, if on the partition of the general tract, they should not be allotted to the grantor. Subject to this contingency the conveyance is valid *and passes the interest of the grantor."* (Italics ours.)

When Scoville made the agreement with the appellants that their investment would be repaid two for one out of 15% of the gross production of the well, he made what amounted, in equity, to a conveyance of whatever interest in the well he possessed, such conveyance creating a burden in the nature of a trust deed upon his interest to secure the payment of the money. The fact that he did not own the full interest in the well, and that thus, in the absence of an express or implied agreement by the other co-owners, the conveyance would not bind their interests, does not prevent it from binding the interest of Scoville, and *Gates v. Salmon* so holds.

Conclusion.

As decided by the California District Court of Appeal in a case in which a hearing was denied by the Supreme Court of California, and which involved precisely the same facts as the case at bar, *Recovery Oil Co. v. Van Acker,* 79 Cal. App. 2d 639, 180 P. 2d 436, 96 Cal. App. 2d 909, 216 P. 2d 483, the Bullens and Haywards have what we think may be properly termed a limited royalty, constituting an estate in the working interest of Treasure Well No. 8, in the nature of a trust deed, which secures the payment to them of the sum of $10,000.00, with interest from the date or dates when payments should have been made thereon; this estate covers those parts of the working interest owned by everyone who was a party to or is bound by the so-called two for one agreement; and without any peradventure of a doubt, it covers that part of the working interest, to-wit, 19% of the total net production from the well, owned by the appellee Walter B. Scoville, who negotiated and signed the agreement.

Respectfully submitted,

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